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November 19, 2003

TO: Each Supervisor

FROM: Thomas L. Garthwaite, MD
Director and Chief Medical Officer

A handwritten signature in dark ink, appearing to read "Thomas L. Garthwaite", is written over the printed name and title.

SUBJECT: HEALTH DEPARTMENT BUDGET COMMITTEE OF THE WHOLE

This is to provide an update on the Department of Health Services' (DHS) fiscal outlook and the status of activities related to the implementation of Scenario III of the Department's system redesign plan.

DHS Fiscal Outlook

The attached schedule provides an update of the Department's Fiscal Outlook since the last Health Department Budget Committee of the Whole of September 16, 2003. This forecast takes into account changes that result from the Fiscal Year 2003-04 Supplemental Budget Resolution.

The Department's forecast budget surplus in Fiscal Year 2003-04 has increased by \$56 million since the forecast was presented to your Board on September 16, rising from \$271.5 million to the current forecast amount of \$327.5 million. The forecast shortfall through Fiscal Year 2007-08 has declined from \$860.1 million to \$724.7 million. These updated amounts include an additional \$87.4 million revenue associated with the federal Centers for Medicare and Medicaid Services' (CMS) September 30, 2003, approval of AB 915, which allows the State to draw federal matching dollars to cover unreimbursed Medi-Cal costs in the outpatient setting. Approval of this funding was delayed due to lengthy consideration by CMS.

While the Department's estimated cumulative shortfall in Fiscal Year 2007-08 has decreased to \$724.7 million, there is still need for caution, as there are a number of things that could occur between now and then that would have a significant impact on the budget deficit. These include the inability to close or transfer operation of Rancho Los Amigos National

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Rehabilitation Center or close 100 inpatient beds at LAC+USC Medical Center by or after June 30, 2004; failure to obtain Federally Qualified Health Center (FQHC) status or other continuation of cost-based reimbursement for the Department's clinics and hospital outpatient areas after June 30, 2005; and, the potential re-basing by the federal government of the Selective Provider Contracting Program waiver. Should these three events transpire, the Department's cumulative shortfall could grow to be nearly \$1.6 billion in Fiscal Year 2007-08.

Of particular concern is the prospect of obtaining FQHC status for the Department's outpatient program. As you know, the federal Health Resources Services Administration (HRSA) denied the Department's application for FQHC status. While the Department is continuing to work with HRSA and intends to appeal this determination, the prospects for achieving this revenue appear in significant doubt. The revenue loss associated with not obtaining FQHC status, and thus retain cost-based reimbursement after the expiration of the Waiver in 2005, will result in the loss of \$182.3 million in revenue through Fiscal Year 2007-08, beginning in Fiscal Year 2005-06.

Below is a summary of the major changes in the Department's fiscal forecast.

Other Changes to Forecast

The forecast also contains a number of adjustments related to changes not related to the implementation of Scenario III, these include:

Pharmacy Costs: Based on revised projections associated with anticipated rise in the cost of pharmaceuticals, the forecast has been updated to reflect a cumulative increase of \$41.2 million in pharmacy costs over the next five years.

CHIP Revenue: Based on an update received from the State, estimated revenues associated with the California Healthcare for the Indigent Program (CHIP) will increase by \$40 million over the five year forecast.

Salary and Employee Benefit Costs: Updates in salary and employee benefits costs to reflect more current information, as approved in the Department's Supplemental Budget Resolution, resulted in reduced expenditure through Fiscal Year 2007-08 of \$28.1 million.

Increase in CHP Tangible Net Equity: The Community Health Plan's (CHP) excess Tangible Net Equity to be contributed to the Department's designation fund, and thus reduce the anticipated deficit, has grown by a cumulative \$17.4 million over the forecast period as a result of increased health plan enrollment and staff attrition.

Cost of Living Adjustments: Based on updated Consumer Price Index data, the Department's anticipated cost of living adjustment for services and supplies has increased by \$12.7 million over the five year forecast.

the January 1, 2004, effective date for new state mandated nurse staffing ratios. The national nursing shortage has made recruitment of nursing staff difficult and as a result, the Department is forecasting not spending \$12.7 million of these funds in this fiscal year, which will result in a five year savings of this amount. This forecast will be adjusted regularly to reflect the Department's efforts to recruit and hire new licensed nursing personnel.

Miscellaneous Changes: Other miscellaneous changes in the Department forecast will result in a reduction of \$3.7 million in the deficit forecast over five years.

Implementation of Scenario III

While the major components of Scenario III were implemented in Fiscal Year 2002-03, there remain several areas in which the requisite savings were not achieved and work continues. These are the following:

Psychiatric Services

As was discussed in the Department's last forecast, the Scenario III savings target associated with psychiatric services has been reduced from the original amount of \$20.2 million to \$16.5 million. Thus far, the Department has successfully, in collaboration with the Department of Mental Health (DMH), transferred the operation of the outpatient psychiatric programs at King/Drew Medical Center from DHS to DMH. The Department is continuing to work with DMH on the transfer of the operation of the outpatient psychiatric program at LAC+USC Medical Center.

The original \$20 million savings target for psychiatric services reflected the difference in the variable cost associated with providing psychiatric services at DHS facilities and the amount of reimbursement provided by DMH. While DHS has identified some potential revenue opportunities in this area, such as reducing the number of Medi-Cal administrative or denied days, the funds associated with these efforts will be far short of the \$16.5 million savings target. Given the Department's projected deficit, it cannot afford to continue to provide the current level of emergency and inpatient psychiatric services without an increased contribution from DMH.

DHS has met numerous times over the past two years with DMH on this matter and has not been successful in either obtaining increased funding or divestiture of these programs. While DMH has challenged the cost assumptions provided by DHS and has indicated that differences in clinical approach, such as the operation of medical education programs in DHS facilities, it has not provided data to support its assertions. Additionally, DHS has broached with DMH the possibility that it take over the delivery of these services, either in DHS facilities or through contracts with private providers, but this suggestion has been rejected by DMH.

The Department intends to continue its discussions with DMH; however, if increased funds are not forthcoming, DHS will be unsuccessful in achieving most of the \$16.5 million in savings associated with this initiative.

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Office of Managed Care/Community Health Plan

As discussed in the Department's previous forecast reports, outstanding issues related to the applicability of language in L.A. Care Health Plan's enabling legislation pertaining to the recognition of the County's current Memorandums of Understanding with its labor unions have led to delays in completing negotiations to establish an agreement between the two entities for the provision of administrative services to the Community Health Plan (CHP).

In the meantime, to ensure the continued viability of the CHP, the Department restored \$8 million in funding for CHP for this fiscal year and L.A. Care Health Plan has funded a management consultant to facilitate efforts to strengthen the management and structure of CHP and enhance its operational capacity.

Conclusion

As noted above, although the Department's fiscal outlook in the near term has improved, the future financial forecast remains bleak. The substantial decrease in federal and state revenues after Fiscal Year 2004-05 and the uncertain prospect of long-term stable revenue leaves the Department with a substantial five year projected deficit. Long-term fiscal stability for DHS will require continued cost savings and additional revenues. I will continue to keep your Board apprised of the Department's pursuit of these solutions.

Please let me know if you have any questions.

TLG:ak

Attachments

c: Chief Administrative Officer
County Counsel
Executive Officer, Board of Supervisors

DHS Fiscal Outlook

Attachment A provides an update through October 27, 2003 of the Department's Fiscal Outlook since the last Health Department Budget Committee of the Whole on September 16, 2003. Attachment B is a high level summary of the key developments, and their fiscal impact, since our last update through September 9, 2003. While we are encouraged that the estimated cumulative shortfall through Fiscal Year 2007-08 has decreased to \$724.7 million, we remain cautious. In the event that any of the following three events transpire, they could cause this estimate to increase once again, as follows:

	<u>\$ In Millions</u>
Estimated Cumulative Year-End Fund Balance/ (Shortfall) as of October 27, 2003	\$(724.7)
--Inability to Close/Transfer Rancho and Reduce LAC+USC Beds by 100 on June 30, 2004, or thereafter.	(393.9)
--Inability to Extend CBRC Revenues (or obtain FQHC approval) Beyond Current 1115 Waiver Expiration (June 30, 2005)	(182.3)*
--Federal "Re-basing" of SPCP Waiver	(374.6)
<u>Potential Estimated Cumulative Year-End Fund Balance/(Shortfall) as of October 27, 2003</u>	<u>\$(1,675.5)</u>

*Estimated net loss after AB 915 backfill.

DHS, along with the CAO, County Counsel and the County's Legislative Strategist, continue to pursue preventing these three events from transpiring.

COUNTY OF LOS ANGELES - DEPARTMENT OF HEALTH SERVICES
FISCAL OUTLOOK - 10/27/2003
 (\$ IN MILLIONS BASED ON FY 03-04 SUPPLEMENTAL BUDGET RESOLUTION)

Line #		FISCAL YEARS / COLUMNS						
		2002-03 (1)	2003-04 (2)	2004-05 (3)	2005-06 (4)	2006-07 (5)	2007-08 (6)	TOTAL (7)
1.	Surplus/Deficit as of June 26, 2002							
2.	Scenario III Reductions / Use of Designation Funds							
3.	Original Fiscal Stabilization Revenue Request to help fund Scenario III (Not Budgetary Shortfall by FY)							
4.	Forecast Update							
5.	Current Surplus/(Shortfall) without Additional Funding							
	Additional Funding							
6.	Measure B							
7.	Acceleration of Rancho Alternative Governance or Closure							
8.	Current Law DSH Redistribution if Rancho Closed and High Desert is Closed							
	State/Federal Transition Agreement							
9.	SPC/UPL (SB 1255)							
10.	Outpatient Lawsuit Settlement - Federal Share							
11.	Subtotal Additional Funds							
12.	Annual Surplus/(Shortfall) ^{(H)(I)}							
13.	Beginning Current Fiscal Year Fund Balance							
14.	Cumulative Year End Fund Balance/(Shortfall) ^{(H)(I)}							
15.	Impact of June 30, 2003 Rancho closure (191 beds) delemtent to July 1, 2004							
16.	Impact to Beginning Current Fiscal Year Fund Balance							
17.	Revised Cumulative Year End Fund Balance/(Shortfall)							
	Impact of LAC-USC Medical Center 100 Acute Bed Reduction delemtent to July 1, 2004 ^(A)							
18.	Revised Cumulative Year End Fund Balance/(Shortfall)							

NOTES TO FISCAL OUTLOOK

- * The \$56.8 million of FY 02-03 service cuts are efficiencies already in the FY 02-03 Budget base at this point in time and; therefore, doesn't appear on this schedule.
- (A) These amounts are extrapolations from the original 90% Medicaid block grant request used to determine the fiscal stabilization revenues for the June 2002 DHS Strategic Plan, which only extended through FY 05-06.
- (B) Reflects the use of \$254.9M in fund balance to consistently show where the Department would stand without the "Additional Funding" items.
- (C) Reflects release of the \$96.1M trust fund reserve.
- (D) If CBRC/FQHC is not available after June 30, 2005, CBRC revenues, net of AB 915 backfill, will decline by \$57.8M, \$60.7M, and \$63.8M for FY's 05-06, 06-07, and 07-08, respectively.
- (E) Represents the cumulative total change starting with the first year a net surplus is not realized on the "Current Surplus/(Shortfall) without Additional Funding" line (FY 03-04).
- (F) Per FY 03-04 Supplemental Budget Resolution.
- (G) Up to \$20.0M of the FY 03-04 SPC/UPL dollars may require DSH flexibility to be retained.
- (H) Per State DHS, CMS may "re-base" the Medicaid Upper Payment Limit (UPL) beginning FY 05-06. The impact on County DHS of this potential action is estimated to result in reductions of Medicaid revenues from FY 02-03 levels. These estimated reductions totaling \$374.6M, are \$97.6M, \$124.9M, and \$152.1M, for FY's 05-06, 06-07 and 07-08, respectively, and are not reflected in the above. When the UPL is fully implemented, the value could be as high as \$198.0M. There is also a non-hospital clinic UPL, which the State has yet to compute, that could further reduce County DHS' Medicaid revenues. Further, the full realization of the Scenario III savings, future State and Federal Budgets, accelerating healthcare inflation, and the President's Medicaid Relief Proposal create significant uncertainty regarding the Department's Fiscal Outlook.
- (I) These amounts are potentially improved by managed care supplement and DSH flexibility proposals currently being worked on with the State and Federal governments.
- (J) Reflects a beginning fund balance of \$366.9M less the \$245.9M fund balance included in the FY 02-03 Supplemental Budget Resolution.
- (K) Reflects a beginning fund balance of \$384.9M less the \$31.8M fund balance included in the FY 03-04 Supplemental Budget Resolution and less \$223.1M to fund current year operations included on the "Forecast Update" line.
- (L) Defer to July 1, 2004 LAC-USC Medical Center 100 bed reduction. Reduce 100 beds for FY 04-05 and future years. Due to delayed impact of DSH we will receive \$2.0M in FY 05-06.

LAC/DHS

SUMMARY OF CHANGES IN DHS FISCAL OUTLOOK
SEPTEMBER 9, 2003 THROUGH OCTOBER 27, 2003

	Fiscal Year/\$ In Millions					Totals
	FY 03-04	FY 04-05	FY 05-06	FY 06-07	FY 07-08	
- Revised Estimated Cumulative Year-End Fund Balance/Shortfall - September 9, 2003	\$271.5	\$ 223.4	\$(90.7)	\$(450.8)	\$(860.1)	\$(860.1)
- Add new AB 915 revenue due to CMS approval on September 30, 2003 following year-long consideration.	27.7 ⁽¹⁾	14.3	14.7	15.1	15.6	87.4
- Increase pharmacy costs based on Supplemental Budget Resolution approved on September 16, 2003 and annual CMS COLA projections update.	-	(3.9)	(8.1)	(12.4)	(16.8)	(41.2)
- Increase estimated CHIP revenues based on State update received September 24, 2003 and the correction of previous estimate.	8.0	8.0	8.0	8.0	8.0	40.0
- Reduce S&EB costs based on Supplemental Budget Resolution, approved September 16, 2003.	1.7	3.9	5.7	7.5	9.3	28.1
- Increase estimated excess CHP net equity to be contributed to DHS designation fund based on new Office of Managed Care estimates, as of September 11, 2003.	2.3	3.0	3.6	4.1	4.4	17.4
- Increase S&S COLA per latest USBLS CPI for LA/Orange/Riverside counties, as of September 29, 2003.	-	(1.2)	(2.5)	(3.8)	(5.2)	(12.7)
- Reduce cost of Nurse Staffing Ratio compliance based on facility-forecasted delays received on September 30, 2004.	12.7	-	-	-	-	12.7
- Change in current fiscal year operating forecast received on September 30, 2003 / Other.	3.6	4.6	7.1	(1.5)	(10.1)	3.7
- Forecast improvement roll-forward.	-	56.0 ⁽⁴⁾	84.7 ⁽⁴⁾	113.2 ⁽⁴⁾	130.2 ⁽⁴⁾	-
Revised⁽²⁾ Estimated Cumulative Year-End Fund Balance/(Shortfall) - October 27, 2003	\$327.5	\$ 308.1	\$ 22.5	\$(320.6)	\$(724.7)	\$(724.7)⁽³⁾

Notes

⁽¹⁾ Represents Fiscal Years 2002-03 and 2003-04 anticipated AB 915 revenues, since the CMS approval is retroactive to July 1, 2002.

⁽²⁾ Assumes Rancho Los Amigos NRC and LAC + USC 100 beds will be closed June 30, 2004.

⁽³⁾ Total change over five years of \$135.4 million (\$860.1 million - \$724.7 million) since last update is less than 1% of five years of DHS operating budgets at the current level of \$3.3 billion per year.

⁽⁴⁾ These amounts represent the cumulative change in the forecast from the prior fiscal year. For example, the \$56.0 million in Fiscal Year 2004-05 is \$327.5 million, \$271.5 million from Fiscal Year 2003-04.